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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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A Lower-Valued Dollar . . .

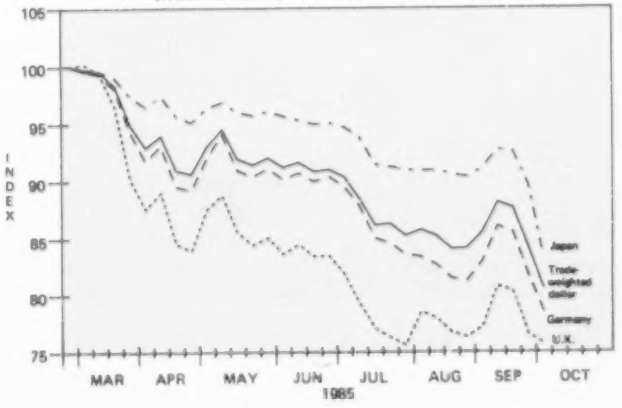
Against the backdrop of several signs of a pickup in business activity, still rapid M1 money supply growth and a steep decline in the external value of the dollar, the Federal Reserve's policy-setting Federal Open Market Committee met last week to decide where to go from here. To some observers, prospects for more rapid economic growth and well above-target money numbers warrant a firming of the money and credit reins. To others, the still soggy pace of business throughout a good chunk of the manufacturing sector, tumbling commodity prices and stepped-up efforts to lower the dollar's external value, all suggest that a case could be made for an easier monetary policy. In light of this dilemma, what's a policymaker to do? It seems that the best course would be to walk a fine line between either further ease or tightening, thereby putting monetary policy initiatives on hold one more time.

In practical terms, such a steady policy course suggests the continuation of generous reserves provisioning to the banking system, further tolerance of today's M1 bulge—while attempting to keep both M2 and M3 at or near their respective target bands—and generally steady interest rates. By keeping to the middle ground, the Fed minimizes the potential for an overheating of business activity and more inflation on the one hand, or an uptick in the dollar's relative value and further weakness in the goods-producing sector on the other. If so, then it appears a good bet that the combination of stable interest rates and a lower-valued dollar will provide the fuel necessary for faster, rather than slower growth in the months ahead, and a broadening of today's business expansion beyond such interest rate-sensitive industries as housing and automobiles, to—at long last—those industries which either compete with imports, or export abroad.

. . . And A Narrower Trade Deficit . . .

It is these latter industries which have received increasing attention in recent months—from the press to economists to Congress which now has before it a volume of pending protectionist legislation unprecedented in the postwar era. The strong dollar has been a key factor inhibiting U.S. economic growth over the past year since it has placed numerous goods-producing industries in their own mini-recession. Industrial production today is only a shade higher than a year ago, and capacity utilization nationwide—which now stands at 80.5 percent—is actually 1.5 percentage points below a year ago. Thus, the decline in the dollar's external value of more than 19 percent on a trade-weighted basis since it reached record highs at the end of last February (see chart) has been welcomed by a broad cross-section of industries. The lower dollar should eventually curb imports of foreign goods, help American products compete more effectively in the world markets, stimulate employment and, last but not least, cool the surge of protectionist sentiment.

INDEXES OF TRADE-WEIGHTED U.S. DOLLAR AND U.S. DOLLAR VS. SELECTED FOREIGN CURRENCIES (WEEK ENDING FEBRUARY 27, 1985=100)



The dollar's descent raises the hope that some of the imbalances which developed during its unprecedented climb will soon be reversed—especially the widening divergence between domestic demand and production. Real domestic demand, or the GNP less the trade deficit, advanced at an average annual rate of more than 3½ percent in the January-June period, or well above the anemic, 1.1 percent, inflation-adjusted GNP growth rate reported for the period. This strong domestic demand did not result in a corresponding growth in domestic output, because a big chunk of it was satisfied from abroad.

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The inflation-adjusted net export deficit in the GNP widened by some $20½ billion in the first half of 1985 compared with yearend 1984—subtracting almost 2½ percentage points from the real GNP growth rate.

Although it is still premature to expect that the recent slide in the dollar's value has begun to reduce the trade deficit, the trend in July and August may be a sign of what's to come. In those months, the red-ink total narrowed by more than 20 percent compared with the immediately preceding two months. Although the shrinking of the trade deficit was due almost exclusively to a decline in imports while exports remained virtually stagnant, the import drop does not, however, appear to be associated with a slowing in domestic business activity. On the contrary, the Commerce Department's "flash" estimate of inflation-adjusted GNP growth of 2.8 percent annual rate in the third quarter, nearly three times faster than the increase posted during the first half of the year, implies that the business expansion may be picking up steam, and will soon be reinforced by the positive effects of a lower dollar. Indeed, the narrower third quarter trade deficit now taking shape could add up to one full percentage point to the GNP "flash" estimate already released.

. . . Could Spell Faster Growth

The primary beneficiary of reduced imports will be the goods-producing sector, particularly hard-hit manufacturing industries, which in September posted the steepest drop in employment in nearly three

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 10/2/85	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	178.046	– 3.698	+15.687
Loans to Depository Inst.	1.440	+ .178	– 4.733
Float	1.271	+ .803	+ .853
Total Reserve Bank Credit	193.581	– 2.750	+12.515
Treasury Deposits with Federal Reserve Banks	3.672	– 2.929	– 4.070
Currency in Circulation	187.486	– .046	+11.858
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	125.921	– 2.121	+ 9.250
	9/25/85		
Member Bank Reserves:			
Total Reserves Held	43.075	– .037	+ 5.393
Excess (Deficiency)	.643	– .017	+ .116
Net Free Reserves	.128	+ .191	+ .342

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1 (9/23/85)	609.8	+ 14.3‡	+ 10.8‡
M2 (August '85)	2,513.7	+ 11.2	+ 9.6
M3 (August '85)	3,136.4	+ 7.9	+ 8.9
Domestic Nonfinancial Debt (2nd Q'85)	6,317.3	+ 12.2	+ 13.6

†Seasonally adjusted.

*Seasonally adjusted annual rate.
‡Four-week moving average.

New York Money Market

Offering Rates 10/4/85	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	6.95%	7.21%	7.38%
* Federal Agencies	7.85	8.30	9.10
* Municipal Notes—High Grade (46% Taxable Equivalent)	8.89	8.98	9.63
Negotiable Time CDs Manufacturers Hanover		Rates By Arrangement	
* Secondary Market—Prime	7.75	7.85	8.15

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	7.60%	Nov.	7.70%
15- 29 days	7.65	Dec.	7.70
30- 59 days	7.70	Jan.	7.70
60- 89 days	7.75	Feb.	7.70
90-179 days	7.75	Mar.	7.70
180-239 days	7.70	Apr.	7.70
240-270 days	7.70		

‡Industrial Paper—Prime			
30- 89 days	7.73%	†Federal Funds Effective Rate	7.65%
90-120 days	7.75		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'85	$ 3,853	$ 3,811	$ 3,645
Gross National Product (1972 Dollars)*	2nd Q'85	$ 1,671	$ 1,664	$ 1,639
Percent Change, Annual Rate	2nd Q'85	1.9	0.3	7.1
Change in Consumer Prices*	Aug '85	2.4%	2.4%	4.8%
Change in Producer Prices*	Aug '85	– 3.6%	3.6%	– 2.4%
Civilian Employment (Thousands of Persons)†	Sep '85n	107,544	107,172	105,394
Unemployment as % of Civilian Labor Force†	Sep '85n	7.1%	7.0%	7.4%
Personal Income*	Aug '85	$ 3,199	$ 3,190	$ 3,046
Leading Indicators Composite Index (1967=100)†	Aug '85n	170.1	169.0r	164.4
Industrial Production Index (1977=100) †	Aug '85	124.8	124.4	123.5
Net Change in Consumer Installment Credit †	Jul '85	$ 6.25	$ 5.23	$ 6.48
U.S. Merchandise Trade Balance †	Aug '85	–$ 9.90	–$ 10.51	–$ 10.09
Plant and Equipment Expenditures*	4th Q'85	$387.40(a)	$389.54(a)	$368.29
Private Housing Starts (Thousands of Units)*	Aug '85	1,749	1,647	1,590
New Construction Expenditures*	Aug '85n	$ 344.0	$ 340.2r	$ 321.2
Total Business Inventories †	Jul '85	$ 579.8	$ 579.7	$ 557.2
Total Business Sales †	Jul '85	$ 422.2	$ 418.4	$ 412.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

years. Consumers, who account for nearly two-thirds of all purchases economy-wide, have yet to show any signs of retrenching from their recent spending spree. In fact, the Conference Board's buying plans index, which measures consumers' intentions to purchase such big-ticket items as automobiles, houses and appliances, rose sharply in the past two months and now stands at the highest level since June, 1984.

But what may be different in the current quarter is that consumers seem to be buying more domestic products and fewer imports. Manufacturers' new orders for consumer goods and materials have risen for two consecutive months. What is more, this pickup in demand for domestic goods could be quickly translated to a stepped-up level of production since inventories economy-wide remain very lean. And if stronger demand persists, which is likely in view of the Holiday season now approaching, businesses will begin to rebuild inventories to avoid losing sales.

What it all adds up to is that the economy may well be on the threshold of faster growth for the remainder of this year. One of the indications that the pace of business activity may be quickening in the coming months came from the government's index of leading economic indicators, believed to be a key barometer of future economic activity. It rose a respectable 0.7 percent both in July and August—the best back-to-back gain since the beginning of the year. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (9/18/85)	156,437	+ 139	– 1,413
New York City (9/25/85)	32,582	+ 178	– 2,342
Commercial Paper (9/25/85)	278,429	+ 2,266	+51,202

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/18/85)	253,662	+ 898	+ 5,535
New York City (9/25/85)	60,450	– 386	– 3,668

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/18/85)	689,332	+ 1,915	+ 58,076
New York City (9/25/85)	151,439	– 2,860	+ 11,937

Financial Markets

	Friday 10/4/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.17%	– .10	– 3.39
180-Day Bills†	7.61	+ .21	– 3.35
Longest Bills†	7.96	+ .01	– 3.37
Recent Issues:			
9s 9/30/87	8.84	+ .08	
9⅝s 6/30/89	9.52	+ .10	
10½s 8/15/95	10.34	+ .12	
10⅝s 8/15/15	10.62	+ .12	
Municipals:			
Bond Buyer–20 Bond Index* (10/3/85)	9.33%	– .05	– 1.01
Blue List Total ($ Million)	$1,863	+$ 26	+ $108
30-Day Visible Supply ($ Million)	$2,748	–$1,579	– $946
Total	$4,611	–$1,553	– $838
Corporates:			
Moody's Aa Composite (10/3/85)	11.52%	+ .07	– 1.75
30-Day Visible Supply ($ Million)	$1,345	–$1,095	– $110
Stocks:			
Dow-Jones Averages:			
Industrials	1,328.74	+ 7.95	+ 146.21
Transportation	647.24	+ 3.63	+ 132.21
Utilities	155.16	+ 5.08	+ 16.88
65 Stocks	540.96	+ 5.33	+ 73.60
Standard and Poor's 500 Stocks	183.22	+ 1.93	+ 20.54
N.Y.S.E. Composite Index	105.94	+ 1.12	+ 12.05
N.Y.S.E. Avg. Daily Vol. for Week (000's)	122,096	+21,876	+ 38,968

* 46% Taxable equivalent 17.28%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 10/4/85	Week Ago
Overnight	7.75%	7.50%
1 month	7.94	7.81
3 month	8.00	7.94
6 month	8.13	8.06
1 year	8.50	8.25
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	10.08%	10.01%
Long Term (7 to 15 yrs.)	10.60	10.52

FOREIGN EXCHANGE SPOT RATES

New York Opening (10/4/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01886	53.0300
Canada	.7328	1.3646
Denmark	.1055	9.4750
France	.1255	7.9700
Germany	.3834	2.6080
Italy	.0005669	1764.00
Japan	.004696	212.95
Mexico	.002706	369.50
Netherlands	.3400	2.9415
Switzerland	.4694	2.1305
U.K.	1.4323	.6982

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